



This document is scheduled to be published in the Federal Register on 12/17/2015 and available online at <http://federalregister.gov/a/2015-31660>, and on [FDsys.gov](http://FDsys.gov)

## **FEDERAL HOUSING FINANCE BOARD**

### **12 CFR Part 955**

## **FEDERAL HOUSING FINANCE AGENCY**

### **12 CFR Parts 1201 and 1268**

### **RIN 2590-AA69**

#### **Acquired Member Assets**

**AGENCY:** Federal Housing Finance Board; Federal Housing Finance Agency.

**ACTION:** Notice of proposed rulemaking; request for comment.

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**SUMMARY:** The Federal Housing Finance Agency (FHFA) is proposing amendments to the existing Acquired Member Assets (AMA) regulation, which applies to the Federal Home Loan Banks (Banks). In particular, FHFA proposes to remove from the regulation requirements based on ratings issued by a Nationally Recognized Statistical Ratings Organization (NRSRO), as required by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). Additionally, FHFA proposes to transfer the AMA regulation from the former Federal Housing Finance Board (Finance Board) regulations to FHFA's regulations. FHFA also proposes to reorganize the current regulation and to modify and clarify a number of provisions in the regulation.

**DATES:** FHFA must receive written comments on or before **[INSERT DATE 120 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]**.

**ADDRESSES:** You may submit your comments, identified by Regulatory Information Number (RIN) 2590-AA69, by any of the following methods:

- Agency Web site: [www.fhfa.gov/open-for-comment-or-input](http://www.fhfa.gov/open-for-comment-or-input).

- Federal eRulemaking Portal: <http://www.regulations.gov>. Follow the instructions for submitting comments. If you submit your comment to the Federal eRulemaking Portal, please also send it by email to FHFA at [RegComments@fhfa.gov](mailto:RegComments@fhfa.gov) to ensure timely receipt by the agency. Please include Comments/RIN 2590-AA69 in the subject line of the message.
- Courier/Hand Delivery: The hand delivery address is: Alfred M. Pollard, General Counsel, Attention: Comments/RIN 2590-AA69, Federal Housing Finance Agency, 400 Seventh Street, SW., Eighth Floor, Washington, DC 20219. Deliver the package to the Seventh Street entrance Guard Desk, First Floor, on business days between 9 a.m. and 5 p.m.
- U.S. Mail, United Parcel Service, Federal Express or Other Mail Service: The mailing address for comments is: Alfred M. Pollard, General Counsel, Attention: Comments/RIN 2590-AA69, Federal Housing Finance Agency, 400 Seventh Street, SW., Eighth Floor, Washington, DC 20219.

**FOR FURTHER INFORMATION CONTACT:** Christina Muradian, Principal Financial Analyst, [Christina.Muradian@fhfa.gov](mailto:Christina.Muradian@fhfa.gov), 202- 649-3323, Division of Bank Regulation; or Thomas E. Joseph, Associate General Counsel, [Thomas.Joseph@fhfa.gov](mailto:Thomas.Joseph@fhfa.gov), 202-649-3076 (these are not toll-free numbers), Office of General Counsel, Federal Housing Finance Agency, 400 Seventh Street, SW., Washington, DC 20219. The telephone number for the Telecommunications Device for the Hearing Impaired is 800-877-8339.

## **SUPPLEMENTARY INFORMATION:**

### **I. Comments**

FHFA invites comments on all aspects of the proposed regulation. After considering all comments, FHFA will develop a final regulation. FHFA will post without change copies of all comments received on the FHFA website at <http://www.fhfa.gov>, and will include any personal information you provide, such as your name, address, email address, and telephone number. FHFA will make copies of all comments timely received available for examination by the public on business days between the hours of 10 a.m. and 3 p.m., at the Federal Housing Finance Agency, 400 Seventh Street, SW., Eighth Floor, Washington, DC 20219. To make an appointment to inspect comments, please call the Office of General Counsel at 202-649-3804.

## **II. Background**

### *A. Creation of the Federal Housing Finance Agency*

Effective July 30, 2008, the Housing and Economic Recovery Act of 2008 (HERA)<sup>1</sup> created FHFA as a new independent agency of the federal government. HERA transferred to FHFA the supervisory and oversight responsibilities of the Office of Federal Housing Enterprise Oversight (OFHEO) over the Federal National Mortgage Association (Fannie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac) (collectively, Enterprises), and of the Finance Board over the Banks and the Bank System's Office of Finance. Under the legislation, the Enterprises, the Banks, and the Office of Finance continue to operate under regulations promulgated by OFHEO and the Finance Board until such regulations are superseded by regulations issued by FHFA.<sup>2</sup>

### *B. Dodd-Frank Act Provisions*

Section 939A of the Dodd-Frank Act requires federal agencies to: (i) Review

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<sup>1</sup> Pub. Law No. 110-289, 122 Stat. 2654

<sup>2</sup> See 12 U.S.C. 4511, note.

regulations that require the use of an assessment of the creditworthiness of a security or money market instrument; and (ii) to the extent those regulations contain any references to, or requirements regarding credit ratings, remove such references or requirements.<sup>3</sup> In place of such credit-rating based requirements, the Dodd-Frank Act instructs agencies to substitute appropriate standards for determining creditworthiness. The new law further provides that, to the extent feasible, an agency should adopt a uniform standard of creditworthiness for use in its regulations, taking into account the entities regulated by it and the purposes for which such regulated entities would rely on the creditworthiness standard.

On November 8, 2013, FHFA promulgated a final rule removing references to credit ratings in certain regulations governing the Banks; this rule became effective on May 7, 2014.<sup>4</sup> That rulemaking removed references to credit ratings in FHFA regulations related to Bank investments, standby letters of credit, and liabilities.<sup>5</sup> When those rule amendments were proposed, FHFA stated that it would undertake separate rulemakings to remove NRSRO references and requirements contained in the Banks' capital regulations and in the regulations governing the Banks' AMA programs.<sup>6</sup> In this rulemaking, FHFA is proposing to remove the references to NRSRO credit ratings in the current AMA regulation. FHFA will separately address removal of credit ratings from the capital regulation in a future rulemaking.

### *C. The Bank System*

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<sup>3</sup> See 15 U.S.C. 78o-7 note.

<sup>4</sup> See Final Rule, Removal of References to Credit Ratings in Certain Regulations Governing the Federal Home Loan Banks, 78 FR 67004 (Nov. 8, 2013).

<sup>5</sup> See 12 CFR parts 1267, 1269, and 1270.

<sup>6</sup> See Proposed Rule, Removal of References to Credit Ratings in Certain Regulations Governing the Federal Home Loan Banks, 78 FR 30784, 30786 (May 23, 2013).

The eleven Banks are wholesale financial institutions organized under the Federal Home Loan Bank Act (Bank Act).<sup>7</sup> The Banks are cooperatives; only members of a Bank may purchase the capital stock of a Bank, and only members or certain eligible housing associates (such as state housing finance agencies) may obtain access to secured loans, known as advances, or other products provided by a Bank.<sup>8</sup> Each Bank is managed by its own board of directors and serves the public interest by enhancing the availability of residential credit through its member institutions.<sup>9</sup> Any eligible institution (generally a federally insured depository institution or state-regulated insurance company) may become a member of a Bank if it satisfies certain criteria and purchases a specified amount of the Bank's capital stock.<sup>10</sup> As government-sponsored enterprises, federal law grants the Banks certain privileges. In light of those privileges, the Banks typically can borrow funds at spreads over the rates on U.S. Treasury securities of comparable maturity that are narrower than those available to most other entities. The Banks pass along a portion of their funding advantage to their members and housing associates—and ultimately to consumers—by providing advances and other financial services at rates that would not otherwise be available to their members. Among those financial services are the Banks' AMA programs, under which the Banks provide financing for members' housing activities by purchasing mortgage loans that meet the requirements of the AMA regulation.

#### *D. Acquired Member Assets*

On July 17, 2000, the Finance Board adopted a final AMA regulation, which

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<sup>7</sup> See 12 U.S.C. 1423, 1432(a).

<sup>8</sup> See 12 U.S.C. 1426(a)(4), 1430(a), 1430b.

<sup>9</sup> See 12 U.S.C. 1427.

<sup>10</sup> See 12 U.S.C. 1424; 12 CFR part 1263.

remains in effect.<sup>11</sup> Neither the Finance Board nor FHFA has amended the regulation since its adoption. The current rule authorizes the Banks to acquire certain loans (principally conforming residential mortgage loans) from their members and housing associates as a means of advancing their housing finance mission, and prescribes the parameters within which the Banks may do so. In adopting the rule, the Finance Board noted that AMA was functionally equivalent to the business of making advances. It allowed members and housing associates to use eligible assets to access liquidity for further mission-related lending, while the member or housing associate maintained its exposure to all or a material portion of the credit risk associated with the AMA loans sold to a Bank.<sup>12</sup> The members or housing associates of a Bank, or members or housing associates of another Bank (pursuant to an arrangement between the Bank acquiring the AMA and the Bank in which the participating financial institution is a member), that are authorized to sell mortgage loans to the Bank through its AMA program generally are referred to as participating financial institutions.

The core of the current AMA rule, which remains unchanged in the proposed rule, establishes a three-part test for a loan to qualify as AMA. First, the asset requirement establishes that assets must be conforming whole mortgage loans, certain interests in such loans, whole loans secured by manufactured housing, certain state or federal housing finance agency (HFA) bonds, and certain other assets enumerated in the rule. Second, assets must meet a member-nexus requirement whereby a Bank must acquire the AMA assets from a participating financial institution or another Bank. In either case, the assets

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<sup>11</sup> See Final Rule, Federal Home Loan Bank Acquired Member Assets, Core Mission Activities, Investment and Advances, 65 FR 43969 (July 17, 2000) (*hereinafter* “Final AMA Rule”).

<sup>12</sup> *Id.* at 43974.

acquired by a Bank must be originated or held for a valid business purpose by a participating financial institution (or an affiliate thereof). Finally, to meet the credit risk-sharing requirement, a Bank must structure its AMA products such that a substantial portion of the associated credit risk is borne by a participating financial institution. Specifically, participating financial institutions must provide sufficient credit enhancement on the assets sold so that the AMA purchased by a Bank is equivalent to an asset rated at least investment grade by an NRSRO or such higher rating as required by the Bank.

Banks currently offer two AMA programs -- Mortgage Partnership Finance (MPF) and Mortgage Purchase Program (MPP). FHFA has authorized other mortgage products outside of the AMA rule that are not subject to the requirements of the rule. These products, as structured by the Bank, generally are conduit programs that allow eligible members to access the secondary mortgage markets but do not result in a Bank holding the mortgages on its balance sheet. Non-AMA products currently offered by some Banks are MPF Xtra and MPF Direct.

### **III. The Proposed Rule**

#### *A. Highlights of the Proposed Rule*

The proposed rule would re-organize current 12 CFR part 955 and re-adopt it as part 1268 of FHFA's regulations. More significantly, as required by the Dodd-Frank Act, it would remove and replace references to, or requirements based on, ratings issued by an NRSRO. It would provide Banks greater flexibility in choosing the models they can use to estimate the credit enhancement required for AMA loans. Additionally, the proposed rule would add a provision allowing a Bank to authorize the transfer of mortgage

servicing rights to any institution, including a non-member of the Bank System. The proposal would remove provisions allowing the use of private supplemental mortgage insurance (SMI) in the required member credit enhancement structure. Finally, the proposal would delete some obsolete provisions from the current rule, and clarify certain other provisions.

### *B. Proposed Changes*

As already noted, Section 939A of the Dodd-Frank Act requires federal agencies to review regulations that require an NRSRO assessment of the creditworthiness of a security or money market instrument, or that includes any references to or requirements related to credit ratings issued by NRSROs. The Dodd-Frank Act further requires the removal of such references or requirements. The AMA rule currently establishes a number of requirements based on NRSRO ratings, which the proposed rule would remove or amend consistent with the Dodd-Frank Act mandate. In addition to the proposed changes related to credit ratings, FHFA is proposing other changes that would re-organize, modify, and clarify certain provisions of the current regulation.

#### **1. Definitions Section Proposed § 1268.1**

In the definitions section (current § 955.1 and proposed § 1268.1), FHFA proposes to modify the definition of “expected losses” to remove a reference to NRSROs. As discussed more fully below, FHFA would also make other changes to the definition of “expected losses” to account for the fact that a Bank would have more modelling options under the proposed rule for calculating the required credit enhancement. Also, as discussed more fully below, FHFA would add to the rule a definition for “investment quality” to implement changes needed to remove references in the current rule to specific



NRSRO credit ratings.

FHFA proposes to add to new § 1268.1 definitions for the terms “AMA product,” “AMA program,” “participating financial institution,” and “pool.” FHFA intends for these newly defined terms to help simplify and clarify other provisions in the rule and avoid use of repetitive, descriptive language in those provisions. It also proposes to amend slightly the definition of “AMA” in § 1201.1 to mean “assets acquired in accordance with, and satisfying the applicable requirements of, part 1268 of this chapter [XII], or any successor thereto.”

## 2. Authorization for Acquired Member Assets Section Proposed § 1268.2

FHFA is proposing to amend the language in the current authorization provision (current 12 CFR 955.2) and to reorganize it into separate sections as proposed §§ 1268.2 through 1268.5.

Under the proposed rule, § 1268.2 generally would authorize a Bank to invest in AMA subject to the requirements of parts 1268 and 1272 of FHFA’s regulations. FHFA is also proposing to include in this new authorization section a “grandfather” provision that would allow a Bank to continue to hold any AMA loans that the Finance Board or FHFA previously authorized for purchase, even if the loan would not meet the requirements of the proposed rule. This proposed provision, set forth at § 1268.2(b), would cover loans that were authorized for purchase by rule, order, or other agency action such as waiver of particular requirements so a Bank to purchase the loan.<sup>13</sup> It

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<sup>13</sup> For example, on August 5, 2011, FHFA waived the ratings requirement for SMI providers in the current regulation to allow Banks to continue to buy loans that used SMI as part of the credit enhancement structure, even though no SMI provider met the ratings requirement. This grandfather provision would allow the Banks that bought loans pursuant to that waiver to continue to hold those loans even if FHFA changes the credit enhancement provision to no longer allow SMI, as it proposed to do in this rulemaking.

would assure that a Bank could continue to hold any legacy loans, including those that no longer meet the credit enhancement or other requirements in the proposed rule. It would replace the current provision that allows a Bank to continue to purchase and hold loans that had been authorized under the Finance Board's and FHFA's former Financial Management Policy even if the credit enhancement structure did not meet the current AMA rule.<sup>14</sup> While the proposed grandfather provision would not authorize continued purchase of AMA that do not comply with the proposed rule, FHFA believes that all currently active AMA products would meet the requirements in proposed part 1268.

FHFA proposes to move the loan type, member nexus, and credit enhancement requirements found in current 12 CFR 955.2 to §§ 1268.3, 1268.4, and 1268.5. As discussed below, FHFA is also proposing to make other changes to these provisions.

### 3. Asset Requirement Section Proposed § 1268.3

#### a. Renaming section

FHFA is proposing to rename this section from the current “loan type requirement” to “asset requirement” because not all of the interests this section authorizes for purchase are technically loans. Specifically, HFA bonds and certificates representing interests in whole loans, which the current rule authorizes, are better classified as securities.

#### b. Asset types

Current 12 CFR 955.2(a) sets forth the types of assets that are permissible as AMA. Proposed § 1268.3(a)(1) and (2) are substantively unchanged from the existing

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<sup>14</sup> FHFA terminated the Financial Management Policy on June 20, 2012, when its revised investment rule (12 CFR part 1267) took effect. See Final Rule: Federal Home Loan Bank Investments, 76 FR 29147, 29151 (May 20, 2011).

rule and set forth the asset types that are eligible for purchase as AMA. The proposed rule, as does the current regulation, allows the acquisition of whole loans that are eligible to secure advances to members under FHFA's advances regulation (part 1266). These assets include: (1) Fully disbursed, whole first mortgage loans on improved residential real property not more than 90 days delinquent; (2) mortgages or other loans, regardless of delinquency status, to the extent that the mortgage or loan is insured or guaranteed by the United States or any agency thereof, or otherwise is backed by the full faith and credit of the United States, and such insurance, guarantee, or other backing is for the direct benefit of the holder of the mortgage or loan; (3) other real estate-related collateral provided that such collateral has a readily ascertainable value, can be reliably discounted to account for liquidation and other risks, can be liquidated in due course, and that the Bank can perfect a security interest in such collateral; and (4) when acquired from community financial institution (CFI) members or their affiliates, small business loans, small farm loans, small agri-business loans, or community development loans, in each case fully secured by collateral other than real estate, or securities representing a whole interest in such secured loans, provided that such collateral has a readily ascertainable value, can be reliably discounted to account for liquidation and other risks, and can be liquidated in due course.

c. Restrictions on certain loans

FHFA is proposing to adopt as § 1268.3(a)(1) the current regulation provision that excludes from AMA those single-family mortgages where the loan amount exceeds the conforming loan limits established pursuant to 12 U.S.C. 1717(b)(2). This limit is consistent with the limits imposed on the Enterprises. As noted when the Finance Board first adopted the AMA rule, it intended this provision to prohibit purchase of jumbo loans

and to create a level playing field with the Enterprises concerning the types of loans that a Bank can purchase.<sup>15</sup>

As a point of clarification, FHFA confirms that under the amended rule, loans on properties located in designated “high-cost areas,” where the conforming loan limit is adjusted in accordance with the criteria established in 12 U.S.C. 1717(b)(2), would remain eligible for purchase as AMA as long as the loan value is within the adjusted conforming loan limit. The criteria in 12 U.S.C. 1717(b)(2), as currently enacted, allows that the conforming loan limits:

may be increased by not to exceed 50 per centum with respect to properties located in Alaska, Guam, Hawaii, and the Virgin Islands. Such foregoing limitations shall also be increased, with respect to properties of a particular size located in any area for which 115 percent of the median house price for such size residence exceeds the foregoing limitation for such size residence, to the lesser of 150 percent of such limitation for such size residence or the amount that is equal to 115 percent of the median house price in such area for such size residence.

FHFA specifically requests comments as to any issues regarding a Bank’s purchase of loans as AMA in designated high-cost areas as well as any issues related to whether the rule should continue to limit AMA loans to those that meet the conforming loan limits more generally.

FHFA is proposing to add language to § 1268.3(a)(3) and (b) to restrict a Bank from purchasing as AMA any home mortgage loans made to any directors, officers, employees, attorneys, or agents of a Bank or of the selling institution unless the board of directors of the Bank has specifically approved such purchase by resolution.<sup>16</sup> This

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<sup>15</sup> See Final AMA Rule, 65 FR at 43974.

<sup>16</sup> This restriction would also apply with regard to an interest in whole loans under proposed § 1263.3(d), given that such interest must be in loans that otherwise meet the requirements of proposed § 1263.3(a) or (b) for the interest to qualify as AMA.

restriction is statutory with regard to home mortgages used as collateral for advances.<sup>17</sup>

The proposed change would extend the restriction to AMA purchases. Loans made to such persons pose the same or greater risk when purchased by a Bank as when taken as collateral for advances. The restriction would be implemented by citing to 12 CFR 1266.7(f) of the FHFA regulations, which is the provision that implements the statutory restriction with regard to advances.<sup>18</sup> FHFA does not propose to apply the restriction to HFA bonds, given that FHFA does not apply the restriction to securities allowed as collateral for advances under part 1266 of this chapter.

#### d. Manufactured housing loans

The current AMA regulation allows the purchase of manufactured housing loans regardless of whether such housing constitutes real property under state law, and FHFA is not proposing changes to this provision (proposed as § 1268.3(b)). FHFA recognizes that the Enterprises also may purchase manufactured housing loans that are chattel loans under the Federal National Mortgage Association Charter Act and the Federal Home Loan Mortgage Corporation Act. In addition, under its advances regulation, FHFA considers chattel loans on manufactured housing to be residential housing finance assets for purposes of the long-term advances proxy test, and allows Banks to extend long-term advances to members for the purchase or funding of such loans.<sup>19</sup>

Other FHFA regulations, however, treat chattel loans on manufactured housing differently from loans on real property. For example, in 2010, FHFA adopted a change to the definition of “mortgage” as used in the Enterprise housing goals regulations with the

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<sup>17</sup> 12 U.S.C. 1430(b).

<sup>18</sup> 12 CFR 1266.7(f)

<sup>19</sup> See 12 CFR 1266.1 and 1266.3.

result that purchases of chattel loans on manufactured housing would not qualify for credit under the housing goals.<sup>20</sup> FHFA adopted the same definition of “mortgage” in the Bank housing goals regulations so chattel loans on manufactured housing also do not qualify for credit under Bank housing goals.<sup>21</sup> In its proposed Enterprise duty to serve regulations, FHFA similarly proposed that it would consider only manufactured housing loans titled as real property toward the Enterprises’ duty to serve underserved markets.<sup>22</sup>

FHFA is also concerned that chattel loans display a higher level of default risk, and present greater credit and operational risks, than other mortgage loans authorized for purchase under the AMA regulation. Given these concerns and the differences in how some current FHFA regulations treat chattel loans, FHFA specifically requests comment as to whether it should continue to authorize the purchase of manufactured housing loans as AMA if relevant state law considers the loans as chattel loans.

e. Certificates representing interests in whole loans

Proposed § 1268.3(d) is a new provision. It would bring into the rule text the authority for Banks to acquire as AMA certain certificates representing interests in whole loans. When the Finance Board adopted the current AMA rule, it noted, in response to comments, that the rule allowed the Banks to buy structured products as AMA, provided the products met certain identified conditions. The proposed language would adopt in the rule text the conditions that were set forth in this discussion. Currently, this authority is set forth in a discussion in the **Supplementary Information** of the Federal Register

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<sup>20</sup> See Final Rule: Enterprise Housing Goals; Enterprise Book-entry Procedures, 75 FR 55892, 55896-895 (Sept. 14, 2010). FHFA continued this exclusion in its most recently adopted Enterprise housing goals rule. See 12 CFR 1282.1 (definition of “mortgage”).

<sup>21</sup> See Final Rule: Federal Home Loan Bank Housing Goals, 75 FR 81096, 81100 (Dec. 27, 2010).

<sup>22</sup> See Proposed Rule: Enterprise Duty to Serve Underserved Markets, 75 FR 32099, 32101-105 (June 7, 2010). FHFA has not yet adopted this proposed rule as a final rule.

release adopting the current regulation.<sup>23</sup> The Finance Board approved one AMA product under this authority (in December 2002), which is now inactive. By moving the preamble language to the rule text, FHFA would clarify that such programs are possible under the amended regulation and bring all relevant authority into the rule text. FHFA continues to believe that under the circumstances in proposed § 1268.3(d), the use of a third party to securitize the whole loans would merely represent a vehicle to invest in certain types of AMA under more favorable terms and should, therefore, be permitted under the rule. However, if the certificates have been created as a security initially available to investors generally, they will not be considered to qualify as AMA under § 1268.3(d).<sup>24</sup>

#### 4. Member or Housing Associate Nexus Requirement Section Proposed § 1268.4

FHFA is proposing to reorganize as § 1268.4(a) and (b) the member nexus requirements currently found at 12 CFR 955.2(b). The proposed rule would continue to impose the requirement that for a loan to be eligible for purchase as AMA, the participating financial institution would have either to originate or issue the assets or have held them for a valid business purpose. The “valid business purpose requirement” in the current regulation accounts for the fact that a member may acquire loans from a non-member during the normal course of business and then sell those loans to the Bank. It excludes any loans that merely pass from a non-member through a member to a Bank, with the intent of extending the benefits of membership to the non-member.<sup>25</sup>

The reference in the proposed rule to assets issued “through, or on behalf of the

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<sup>23</sup> Final AMA Rule, 65 FR at 43974, 43977.

<sup>24</sup> *Id.*

<sup>25</sup> *See* Proposed Rule: Federal Home Loan Bank Acquired Member Assets, Core Mission Activities, Investments and Advances, 65 FR 25676, 25681 (May 3, 2000) (hereinafter 2000 Proposed AMA Rule).

participating financial institution” also carries over from the current regulation. As under the current regulation, the provision would allow HFA bonds issued by an underwriter for the participating financial institution to qualify as AMA.<sup>26</sup>

Proposed § 1268.4(b) would adopt without substantive change current special requirements in 12 CFR 955.2(b)(2)(ii) that apply when a Bank purchases HFA bonds as AMA from a housing associate of another Bank. Under this provision, a Bank may acquire initial-offering taxable HFA bonds from out-of-district associates, provided the Bank in whose district the HFA is located (local Bank) has a right of first refusal to purchase, or negotiate the terms of, a particular bond issue. If the local Bank refuses, or does not respond within three days, the HFA may then offer the bonds to an out-of-district Bank. The Finance Board adopted this approach to preserve the integrity of the Bank Districts, while at the same time preventing any one Bank from denying an HFA in its District from financing that another Bank is willing to provide.<sup>27</sup>

#### 5. Credit Risk-Sharing Requirement Section Proposed § 1268.5

##### a. General Requirement

FHFA is proposing to reorganize as § 1268.5 the credit risk-sharing requirements currently found at 12 CFR 955.2(c) and 955.3. FHFA proposes to re-adopt several of the credit risk-sharing provisions without substantive changes, including the requirement that all AMA loans carry a credit enhancement. Proposed § 1268.5(c) also generally would maintain the design requirement for the credit enhancement structure that helps ensure that the participating financial institution retains an economic incentive to reduce actual losses that is both material in amount and early enough in the structure to be

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<sup>26</sup> Id.

<sup>27</sup> See Final AMA Rule, 65 FR at 43975.



meaningful.<sup>28</sup> Thus, the proposed rule would continue to prohibit any AMA product that removes the participating financial institution's incentive to reduce actual credit losses.

As discussed below, the proposed rule also would change some of the credit risk-sharing provisions to remove references to NRSRO ratings, as required by the Dodd-Frank Act. Proposed § 1268.5(e) would set forth the requirements for the Bank's use of a methodology and model for calculating the credit enhancement obligation that is not necessarily tied to one used by an NRSRO. Additionally, FHFA is not proposing to re-adopt current provisions that allow the use of private SMI or pool insurance as part of the credit enhancement structure. Consequently, FHFA is proposing to remove provisions from the current regulation requiring eligible SMI providers to maintain specific NRSRO ratings.

#### b. Determining Credit Enhancements on AMA Pools

The proposed rule would modify 12 CFR 955.3(a) of the current regulation, and re-adopt it as proposed § 1268.5(b)(1). FHFA's proposed modification to this provision would remove current requirements based on NRSRO ratings and methodologies in accordance with the Dodd-Frank Act. Otherwise, FHFA continues to believe the credit risk-sharing approach in the current regulation is valid. The principles underlying the AMA regulation establish that risks are borne by those entities best suited to manage them. Therefore, the credit risk-sharing requirements provide that participating financial institutions selling mortgages must retain a substantial portion of the credit risk, given their expertise in underwriting mortgages. In requiring the participating financial institution to have "skin in the game," the rule provides them an incentive to sell high-

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<sup>28</sup> Id. at 43967- 98.

quality loans to the Banks and the opportunity to benefit financially from good underwriting practices.

To ensure that participating financial institutions bear a material portion of the credit risk, existing § 955.3(a) currently requires a participating financial institution that sells AMA loans to a Bank to enhance the pool to be equivalent to an asset rated at least the fourth highest credit grade rating from an NRSRO (i.e., to be at least investment grade) or to a higher rating required by the Bank. The provision also requires the Bank to make a determination of the amount of the required credit enhancement using a methodology that is confirmed in writing by an NRSRO to be equivalent to one used by the NRSRO in rating a comparable pool of assets.

Proposed § 1268.5(a)(1) would amend the current provision to remove the requirement that AMA loans be enhanced to a specific rating that is equivalent to one issued by an NRSRO. Under the proposed amendment, a participating financial institution must credit enhance AMA loans to at least “investment quality.”

FHFA proposes to define the term “investment quality” in the AMA regulation by reference to the definition of that term adopted by FHFA in the Bank investment regulation (12 CFR part 1267). That definition reads:

Investment quality means a determination made by the Bank with respect to a security or obligation that, based on documented analysis, including consideration of the sources for repayment on the security or obligation: (1) There is adequate financial backing so that full and timely payment of principal and interest on such security or obligation is expected; and (2) There is minimal risk that the timely payment of principal or interest would not occur because of adverse changes in economic and financial conditions during the projected life of the security or obligation.<sup>29</sup>

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<sup>29</sup> 12 CFR 1267.1 (defining “investment quality”).

Under proposed § 1268.5(b)(1), the Bank could specify as part of the terms and conditions for a particular AMA product that a participating financial institution provide a credit enhancement greater than that needed to enhance the loan or pool to investment quality. The enhancement would need to be defined in relation to a model and methodology of the Bank's choosing, subject to conditions established in § 1268.5(e) of the proposed rule. If a Bank chooses to continue to use the same NRSRO model it currently uses, it would not necessarily need to alter the credit enhancement levels it currently requires, unless FHFA directs it to do so or its estimated enhancement levels otherwise would not comply with the rule. For example, a Bank would need to increase credit enhancement levels if it determined that the credit enhancement currently estimated by its NRSRO model was not sufficient for an asset or pool of assets to be "investment quality" under the proposed definition of that term.

In addition, the proposed rule carries over requirements in the current regulation that a Bank's authority to hold AMA assets is specifically contingent on the Bank complying with FHFA's New business activity (NBA) regulation (12 CFR part 1272).<sup>30</sup> If the terms and conditions for a Bank's new AMA product or a modification to an existing AMA product triggered the requirements of the NBA rule, the Bank would need to file an NBA notice. FHFA would expect the Bank to provide a clear explanation in the notice of how the new or modified product's credit risk-sharing structure meets the AMA credit enhancement requirements, and how the Bank would calculate that obligation.

As now is the case under the current regulation, proposed § 1268.5(c), at least with respect to loans that would not be insured or guaranteed by the U.S. government,

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<sup>30</sup> See Proposed § 1268.2.

would continue to require the participating financial institution providing the credit enhancement to bear the direct economic consequences of actual credit losses on the assets from the first dollar of loss up to expected losses or immediately following expected losses but in an amount equal to or exceeding expected losses.<sup>31</sup> Consistent with previous Finance Board statements, the participating financial institution itself would be required to bear the economic responsibility of the expected credit losses, as required by proposed § 1268.5(c), to ensure participating financial institution involvement and to ensure that the participating financial institution bears the consequences of the credit quality of the asset or pool. The participating financial institution could not transfer this responsibility to an affiliate or non-member entity.<sup>32</sup>

While the current regulation defines “expected losses” as the base loss scenario in the methodology of an NRSRO applicable to a particular AMA asset, the proposed definition would refer to the loss given the expected future economic and market conditions in the model or methodology used by the Bank to calculate the credit enhancement for an AMA product under proposed § 1268.5. This change accounts for the fact that the proposed rule would no longer require a Bank to use an NRSRO model and would accommodate the potential for a Bank to adopt a model that applies a methodology that differs from that used in the Banks’ current models. Otherwise, FHFA believes that this proposed change would not alter what is currently required by the AMA rule; nor is this change intended to alter how a Bank would calculate “expected losses” if

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<sup>31</sup> As is discussed below, FHFA is proposing to change requirements in the current regulation for government insured or guaranteed loans so that members or housing associates would no longer have to bear responsibility for unreimbursed servicing expenses up to the amount of expected losses for the loan to qualify as AMA.

<sup>32</sup> See 2000 Proposed AMA Rule, 65 FR at 25683; see also, Final AMA Rule, 65 FR 43976.

it continued to use its current model. Therefore, as under the current regulation, the proposed rule would require a member to provide a credit enhancement against losses for all non-government insured or guaranteed loans at least equal to the expected losses calculated by the credit enhancement model used by the Bank whether this enhancement is positioned in the first loss position or immediately following the first loss.

The proposed rule at § 1268.5(c)(1)(ii) would also continue to require the participating financial institution to secure fully its credit enhancement obligation in parallel with the requirement for advances to members under part 1266 of this chapter. This provision addresses the concern that a Bank might be exposed to credit risk if the member were not able to comply with its contractual credit enhancement obligation.

The proposed rule would not change the requirement that a Bank determine the necessary credit enhancement on a pool at the earlier of 270 days from the date of the Bank's acquisition of the first loan in a pool or the date at which the pool reaches \$100 million in assets. This provision continues to be relevant in that it addresses safety and soundness concerns that could arise if a Bank did not timely perform the credit enhancement determination on large pools formed over extended periods. This provision ensures the Bank uses its model early enough in the process to determine that the contracted amount of the credit enhancement is sufficient to credit enhance the pool to the level consistent with the terms and conditions of the specific AMA product.<sup>33</sup>

The proposed rule would also continue to require that the credit enhancement must be for the life of the asset or pool. This requirement would exclude, for example, structures that would comply with the credit rating requirement in the first year, but

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<sup>33</sup> See Final AMA Rule, 65 FR at 43975.

would then scale back the amount of the member's credit enhancement in future years so the pool is no longer credit enhanced to the level consistent with the terms and conditions of the AMA product.<sup>34</sup>

The current regulation at 12 CFR 955.3(b) and (c) set forth specific requirements for a Bank to obtain the NRSRO verifications with regard to the adequacy of the credit enhancement structure and Bank's use of the NRSRO model for estimating the required enhancement in each AMA product. Given that under the proposed rule FHFA would no longer require a Bank to use NRSRO models, these requirements would become obsolete, and FHFA is proposing to remove them.

In their place, FHFA is proposing § 1268.5(b)(2), which would require a Bank to document the basis for its conclusion that the contractual credit enhancement required for a particular pool is sufficient to meet the required credit enhancement obligation for a particular AMA product, given the Bank's chosen model's relevant stress scenarios. This information will help FHFA monitor the Banks' use of their models and the adequacy of the specific credit enhancement structures used in each AMA product.

#### c. Transfer of Credit Enhancement Obligation

The proposed rule would modify current 12 CFR 955.3(b)(1) and re-adopt it as § 1268.5(c)(2). This section would establish the acceptable forms a member may use to provide the credit enhancement for AMA loans, subject to certain limitations. The proposed rule would clarify that a participating financial institution, "with the approval of the Bank," may choose to transfer its credit enhancement obligation to its insurance affiliate (but only where the insurance is positioned after the participating financial

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<sup>34</sup> See *id.* at 43976.

institution bears losses in an amount at least equal to expected losses) or to another participating financial institution. The Bank could give this permission either by establishing the required form of credit enhancement in the terms of a particular AMA product, or by providing specific approval for the transfer. The proposed change is consistent with how the AMA regulations are currently applied, and with current Bank practice with regard to AMA product structures and permissible transfers of the credit enhancement obligations.

d. Credit Quality of Mortgage Insurers – Supplementary Mortgage Insurance

Current 12 CFR 955.3(b) of the AMA regulation allows a member to meet part of its credit enhancement obligation through the purchase of SMI, provided that the insurer is rated not lower than the second highest credit rating category. The proposed rule would remove the option to use SMI as part of the credit enhancement structure. While the current AMA regulation addresses use of SMI as part of the credit enhancement structure and minimum criteria for providers of such insurance, it does not address borrower-funded primary mortgage insurance (PMI) or set minimum criteria for providers of PMI. Instead, the rule allows a Bank to set the minimum criteria for PMI providers. Nothing in the proposed rule alters this approach with respect to PMI. FHFA will continue to review the Banks' assessments of PMI providers through the annual examination process.

The main reason for proposing to remove the option to use SMI in the credit enhancement structure is the fact that during the recent financial crisis, no private insurance company maintained the second highest credit rating as required by the current AMA regulation. FHFA had to waive the rule requirement for the products that relied on

SMI for existing business and required the Banks with only products that relied on SMI to develop alternate structures for new business in their programs. Given that the Banks have alternate AMA structures and products that do not rely on SMI and that private mono-line insurers could face similar problems if another financial crisis were to arise, FHFA is proposing to remove these provisions. FHFA also believes that eliminating the use of SMI from authorized credit enhancement structures remains consistent with the intent of the AMA regulation to require participating financial institutions to bear the direct economic consequences of the credit risk associated with AMA loans and not transfer such risk to third parties.

For similar reasons, FHFA also proposes to eliminate the provision in 12 CFR 955.3(b) that authorizes the use of pool level insurance as part of the credit enhancement structure where such insurance covers that portion of the credit enhancement obligation related to geographic concentration or pool size. As discussed in more detail below, however, the proposed rule would still allow a participating financial institution to use U.S. government insurance or guarantees to meet credit enhancement requirements.

FHFA specifically requests comments regarding the use and importance of SMI or private pool insurance as part of an allowable credit enhancement structure. In particular, FHFA solicits comments on what type of requirement could replace the specific credit rating requirement for private insurance providers if it were to retain these insurance options as part of the credit enhancement structure. Additionally, FHFA requests comments on how a Bank might evaluate the claims-paying ability of an insurer in the absence of a specific credit rating requirement. Finally, FHFA requests comment on whether, if it were to adopt in the AMA regulation specific minimum requirements for



providers of SMI and pool insurance, such requirements also should apply to PMI providers.

e. U.S. Government Insurance or Guarantee

The proposed rule would modify current 12 CFR 955.3(b)(1)(ii)(A) and (B) with regard to the use of U.S. government insurance or guarantees as part of the credit enhancement and re-adopt the provision as § 1268.5(d). The proposed provision would clarify that a participating financial institution may provide all or a portion of the required credit enhancement by having the loan insured or guaranteed by an agency or department of the U.S. government. Unlike the current regulation, however, the new, proposed language would not require government insured or guaranteed loans to meet the specific credit enhancement structure requirements (wherein the member bears the first dollar of losses for a loan or pool up to the amount of expected losses or bears losses immediately following expected losses in an amount that equals or exceeds expected losses).<sup>35</sup>

As already noted, the purpose of the credit enhancement structure requirement was to ensure that participating financial institutions, “when responsible for such losses, [had] incentive to seek ways to achieve better than expected performance [for the loans sold as AMA].”<sup>36</sup> As the Finance Board explained, in order for a participating financial institution to meet this structure requirement with respect to government insured or guaranteed loans, given that losses eventually would be covered by the government insurance or guarantee, the participating financial institution would have to bear the economic responsibility of all unreimbursed servicing expenses, up to the amount of

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<sup>35</sup> See 12 CFR 955.3(b)(1)(ii) and (b)(2).

<sup>36</sup> Final AMA Rule, 65 FR at 43977.

expected losses.<sup>37</sup> As a result, the member's credit enhancement obligation for AMA government loans is tied closely to its servicing obligations. This link limits a participating financial institution's ability to transfer mortgage-servicing rights for the AMA government loans to non-participating financial institutions.

In addition, FHFA does not believe that requiring a member to retain an obligation to cover unreimbursed servicing rights for AMA government loans provides an additional incentive to improve underwriting in order to achieve better than expected loan performance. To qualify for government insurance or guarantee, members will already be underwriting loans to standards imposed by the relevant government agency or department. Further, government insurance and guarantee will usually cover any losses experienced on the loan. Therefore, this requirement does not necessarily provide additional protection to the Bank beyond that provided by the government insurance or guarantee.

Thus, FHFA is proposing in § 1268.5(d) to remove the requirement that U.S. government insured or guaranteed loans meet the specific structure requirement now set forth in proposed § 1268.5(c). Proposed § 1268.5(d) would continue to require the credit enhancement provided by government insurance or guarantee be maintained for the entire period a Bank owns the AMA government loan. The proposed rule would not necessarily require that a Bank member maintain the insurance or guarantee. Instead, the Bank would have to ensure that the participating financial institution or another entity maintains the insurance or guarantee for as long as the Bank owns the loan. For example, a Bank might require any entity that acquires the mortgage servicing rights to a loan to

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<sup>37</sup> Id. (explaining how government insured loans meet the credit enhancement requirements of the AMA rule).

maintain the insurance. FHFA believes increasing the flexibility allowed in transferring mortgage-servicing rights under this proposed change would prove beneficial for many smaller or medium sized members. These members, in particular, might wish to sell their AMA government loans into AMA government products but may lack the ability to perform the servicing obligations now required by the AMA regulation. In addition, given changes in the mortgage industry, Banks may find it increasingly difficult to find member institutions to meet the servicing obligations for AMA government loans. Banks may need the flexibility to transfer such obligations to non-member institutions in order to continue to offer the product to a wide cross section of its members. The current regulation does not allow such flexibility with respect to government insured or guaranteed loans.

f. Model and Methodology Validation

Proposed § 1268.5(e) would set forth the specific requirements applicable to a Bank's use of a model and methodology for estimating the required member credit enhancements for AMA loans that a participating financial institution sells to a Bank. Specifically, it would require a Bank to: (1) Validate its model and methodology at least annually and make the results available upon request by FHFA (proposed § 1268.5(e)(1)); (2) institute and maintain a process for monitoring model performance that would include tracking, back-testing, benchmarking, and stress testing a model and its results (proposed § 1268.5(e)(2)) and be otherwise consistent with applicable FHFA model guidance; (3) inform FHFA prior to making any material changes to the model and methodology (proposed § 1268.5(e)(3)); and (4) promptly change its model and methodology as directed by FHFA (proposed § 1268.5(e)(4)).

The requirements of proposed § 1268.5(e) are generally consistent with the requirements governing the Bank's market risk capital models (12 CFR 932.5(c)) and have been added here for safety and soundness reasons. FHFA also expects a Bank to have policies and procedures commensurate with the complexity of the model and methodology, including, but not limited to, a governance structure, oversight by its board of directors, as well as formal controls. Effective model risk management should entail a comprehensive approach in identifying risk throughout the model lifecycle and should be consistent with any applicable FHFA guidance.

As proposed, the rule would allow a Bank to institute changes in its model immediately upon notifying FHFA. FHFA, however, would review a Bank's model and methodology for estimating credit enhancements as part of the annual examination process, as well as through its on-going off-site monitoring program. If FHFA found that the model or the Bank's use of the model were inadequate or did not result in a credit enhancement that would reasonably protect a Bank against risk of loss as required under the proposed rule, FHFA would use authority in the proposed rule to direct the Bank to make changes to the model. FHFA could also use other authorities, such as its authority to issue cease-and-desist orders, to require the Bank to make necessary changes to its model, or AMA products, to address any violations of the regulation or unsafe or unsound practices. FHFA believes that this proposed approach would allow a Bank sufficient flexibility to make timely changes to its credit enhancement model in response to technological or market developments while still allowing FHFA adequate oversight of the Bank's use of its credit enhancement model.

While the proposed new provisions would no longer require a Bank to use an

NRSRO model for estimating the required credit enhancement, nothing in the proposed rule would prohibit a Bank from continuing to use its existing NRSRO model. However, use of all models, including a currently used model, would be subject to the requirements of proposed § 1268.5(e).

#### 6. Servicing Section Proposed § 1268.6

FHFA proposes to add new § 1268.6 to address the servicing of AMA loans. This provision incorporates current FHFA positions, as set forth in a recent regulatory interpretation, on the rights of the Banks to allow for transfer of mortgage servicing rights from the participating financial institution that originally sold the AMA loans at issue.<sup>38</sup> Thus, proposed § 1268.6 would clarify that a Bank can allow for a transfer of servicing rights to any institution, including a non-Bank System member. However, any transfer of mortgage servicing rights may only occur as long as it does not result in the AMA loan failing to meet any requirements of the rule, including the credit enhancement requirement. In particular, because proposed § 1268.5(c) would require that the credit enhancement on an AMA loan not insured or guaranteed by the U.S. government continue to be held by a participating financial institution for the life of the loan, the transfer of servicing cannot result in the transfer of any portion of the credit enhancement obligation to a non-Bank System member. However, as already discussed, changes proposed in § 1268.5(d) would, if adopted, allow the Banks to transfer servicing of government insured or guaranteed AMA loans to non-member institutions, an action that is not necessarily allowed under current regulations.

Proposed § 1268.6 also would require the approval of the Banks that have any

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<sup>38</sup> See Regulatory Interpretation, 2015-RI-01 (June 23, 2015).

ownership interest in the loans prior to the transfer of the servicing obligation. Finally, the proposed provision would provide that the Banks have in place policies and procedures that ensure the transfer of servicing would not negatively affect the credit enhancement on the loans in question or substantially increase the Bank's exposure to risk. FHFA would expect such policies and procedures specifically to address transfers to non-Bank System member servicers given that in the case of default on an obligation to the Bank, a Bank may enjoy more rights against a member than it would against a non-member. For example, the Bank Act provides enhanced status with regard to a Bank's lien on member assets, and the Bank's membership agreement may allow the Bank to take certain actions against a member in the case of a breach of an obligation that would not be available against a non-member.<sup>39</sup> In addition, FHFA would expect policies and procedures to include contingency plans to address a case in which a large servicer fails or is otherwise unable to continue to service a Bank's AMA portfolio.

## 7. Risk-based Capital Requirements

The current regulation at 12 CFR 955.6 established the risk-based capital requirements for AMA, based on NRSRO ratings. These risk-based capital requirements, however, applied only so long as a Bank had not converted to the Gramm-Leach-Bliley Act capital structure and was not yet subject to the risk-based capital requirements in 12 CFR part 932.<sup>40</sup> Given that all Banks have converted their capital structures and are now subject to the AMA credit and market risk charges established by 12 CFR part 932 of the

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<sup>39</sup> See, e.g., 12 U.S.C. 1430(c) and (e).

<sup>40</sup> In adopting the current AMA regulations, the Finance Board noted that the AMA capital requirements in § 955.6 were "interim risk based capital requirements" and when the Finance Board's new Gramm-Leach-Bliley Act capital requirements became effective with respect to a Bank, the Bank would need to hold capital for AMA based on those new requirements. Final AMA Rule, 65 FR at 43979 (July 17, 2000).

current capital regulations, this section has no continuing applicability, and FHFA proposes to remove it.

#### 8. Other Sections -- §§ 1268.7 and 1268.8

Proposed §§ 1268.7 and 1268.8 would adopt without substantive change 12 CFR 955.4 and 955.5 of the current regulation. These provisions address, respectively, reporting requirements for AMA and administrative transactions and agreements between Banks involving AMA.

### **IV. Consideration of Differences between the Banks and the Enterprises**

When promulgating regulations relating to the Banks, section 1313(f) of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (Safety and Soundness Act) requires the Director of FHFA (Director) to consider the differences between the Banks and the Enterprises with respect to the Banks' cooperative ownership structure, mission of providing liquidity to members, affordable housing and community development mission, capital structure, and joint and several liability.<sup>41</sup> The Director also may consider any other differences that FHFA deems appropriate. The changes proposed in this rulemaking apply only to the Banks. Many of the proposed amendments are necessary to implement requirements under the Dodd-Frank Act; a number of others are technical or conforming in nature. FHFA, in preparing this proposed rule, considered the differences between the Banks and the Enterprises as they relate to the above factors and requests comments from the public about whether these differences should result in any revisions to the proposed rule.

### **V. Paperwork Reduction Act**

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<sup>41</sup> See 12 U.S.C. 4513.

The information collection, entitled “Federal Home Loan Bank Acquired Member Assets, Core Mission Activities, Investments and Advances” contained in current 12 CFR part 955 of the regulations that would be transferred to 12 CFR part 1268 by this proposed rule has been assigned control number 2590-0008 by the Office of Management and Budget (OMB). The proposed rule if adopted as a final rule would not substantively or materially modify the current, approved information collection.

## **VI. Regulatory Flexibility Act**

The Regulatory Flexibility Act (5 U.S.C. 601 et seq.) requires that a regulation that has a significant economic impact on a substantial number of small entities, small businesses, or small organizations must include an initial regulatory flexibility analysis describing the regulation’s impact on small entities. FHFA need not undertake such an analysis if the agency has certified the regulation will not have a significant economic impact on a substantial number of small entities. 5 U.S.C. 605(b). FHFA has considered the impact of the proposed rule under the Regulatory Flexibility Act.

FHFA certifies that the proposed rule, if adopted as a final rule, is not likely to have a significant economic impact on a substantial number of small entities because the regulation is applicable only to the Banks, which are not small entities for purposes of the Regulatory Flexibility Act.

### **List of Subjects**

#### **12 CFR Part 955**

Community development, Credit, Federal home loan banks, Housing, Reporting and recordkeeping requirements.

#### **12 CFR Part 1201**



Administrative practice and procedure, Federal home loan banks, Government-sponsored enterprises, Office of Finance, Regulated entities.

12 CFR Part 1268

Acquired member assets, Credit, Federal home loan bank, Housing, Nationally recognized statistical rating agency.

**Authority and Issuance**

For reasons stated in the **SUPPLEMENTARY INFORMATION**, and under the authority of 12 U.S.C. 1430, 1430b, 1431, 4511, 4513, 4526, FHFA proposes to amend subchapter G of chapter IX and subchapters A and D of chapter XII of title 12 of the Code of Federal Regulations as follows:

**CHAPTER IX—FEDERAL HOUSING FINANCE BOARD**

**Subchapter G—[Removed and Reserved]**

1. Subchapter G, consisting of part 955 is removed and reserved.

**CHAPTER XII—FEDERAL HOUSING FINANCE AGENCY**

**Subchapter A—Organization and Operations**

**PART 1201—GENERAL DEFINITIONS APPLYING TO ALL FEDERAL  
HOUSING FINANCE AGENCY REGULATIONS**

2. The authority citation for part 1201 continues to read:

**Authority:** 12 U.S.C. 4511(b), 4513(a), 4513(b).

3. Amend § 1201.1 by revising the definition of “Acquired member assets or AMA” to read as follows:

**§ 1201.1 Definitions.**

\* \* \* \* \*

Acquired member assets or AMA means assets acquired in accordance with, and satisfying the applicable requirements of, part 1268 of this chapter, or any successor thereto.

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#### **Subchapter D—Federal Home Loan Banks**

4. Part 1268 is added to subchapter D to read as follows:

#### **PART 1268—ACQUIRED MEMBER ASSETS**

Sec.

1268.1 Definitions.

1268.2 Authorization for acquired member assets.

1268.3 Asset requirement.

1268.4 Member or housing associate nexus requirement.

1268.5 Credit risk-sharing requirement.

1268.6 Servicing.

1268.7 Reporting requirements for acquired member assets.

1268.8 Administrative transactions and agreements between Banks.

**Authority:** 12 U.S.C. 1430, 1430b, 1431, 4511, 4513, 4526.

#### **§ 1268.1 Definitions.**

As used in this part:

Affiliate means any business entity that controls, is controlled by, or is under common control with, a member.

AMA product means an AMA structure defined by a specific set of terms and conditions that comply with this part.

AMA program means a Bank-established program to buy mortgage loans that meet the requirements of this part, which may comprise multiple AMA products.

Expected losses means the loss given the expected future economic and market conditions in the model or methodology used by the Bank under § 1268.5 and applicable

to an AMA product.

Investment quality has the meaning set forth in § 1267.1 of this chapter.

Participating financial institution means a member or housing associate of a Bank that is authorized to sell mortgage loans to its own Bank through an AMA program, or a member or housing associate of another Bank that has been authorized to sell mortgage loans to the Bank pursuant to an agreement between the Bank acquiring the AMA product and the Bank of which the selling institution is a member or housing associate.

Pool means a group of assets acquired under a given master commitment or similar agreement.

Residential real property has the meaning set forth in § 1266.1 of this chapter.

#### **§ 1268.2 Authorization for acquired member assets.**

(a) General. Each Bank is authorized to invest in assets that qualify as AMA, subject to the requirements of this part and part 1272 of this chapter.

(b) Grandfathered transactions. Notwithstanding paragraph (a) of this section, a Bank may continue to hold as AMA assets that were previously authorized by the Federal Housing Finance Board or FHFA for purchase as AMA, provided that the assets were purchased, and continue to be held, in compliance with that authorization.

#### **§ 1268.3 Asset requirement.**

Assets that qualify as AMA shall be limited to the following:

(a) Whole loans that are eligible to secure advances under § 1266.7(a)(1)(i), (a)(2)(ii), (a)(4), or (b)(1) of this chapter, excluding:

(1) Single-family mortgage loans where the loan amount exceeds the limits established pursuant to 12 U.S.C. 1717(b)(2);

- (2) Loans made to an entity, or secured by property, not located in a state; and
- (3) Loans that would not be eligible to serve as collateral for an advance under § 1266.7(f) of this chapter;
- (b) Whole loans secured by manufactured housing, regardless of whether such housing qualifies as residential real property, unless such loan would not be eligible to serve as collateral for an advance under § 1266.7(f) of this chapter;
- (c) State and local housing finance agency bonds; or
- (d) Certificates representing interests in whole loans if:
  - (1) The loans qualify as AMA under paragraphs (a) or (b) of this section and meet the nexus requirements of § 1268.4; and
  - (2) The certificates:
    - (i) Meet the credit enhancement requirements of § 1268.5;
    - (ii) Are issued pursuant to an agreement between the Bank and a participating financial institution to share risks consistent with the requirements of this part; and
    - (iii) Are acquired substantially by the initiating Bank or Banks.

**§ 1268.4 Member or housing associate nexus requirement.**

- (a) General provision. To qualify as AMA, any assets described in § 1268.3 must be acquired in a purchase or funding transaction only from:
  - (1) A participating financial institution, provided that the asset was:
    - (i) Originated or issued by, through, or on behalf of the participating financial institution, or an affiliate thereof; or
    - (ii) Held for a valid business purpose by the participating financial institution, or an affiliate thereof, prior to acquisition by the Bank; or

(2) Another Bank, provided that the asset was originally acquired by the selling Bank consistent with this section.

(b) Special provision for housing finance agency bonds. In the case of housing finance agency bonds acquired by a Bank from a housing associate located in the district of another Bank (local Bank), the arrangement required by the definition of “participating financial institution” in § 1268.1 between the acquiring Bank and the local Bank may be reached in accordance with the following process:

(1) The housing finance agency shall first offer the local Bank right of first refusal to purchase, or negotiate the terms of, its proposed bond offering;

(2) If the local Bank indicates, within a three-day period, it will negotiate in good faith to purchase the bonds, the housing finance agency may not offer to sell or negotiate the terms of a purchase with another Bank; and

(3) If the local Bank declines the offer, or has failed to respond within the three-day period, the acquiring Bank will be considered to have an arrangement with the local Bank for purposes of this section and may offer to buy or negotiate the terms of a bond sale with the housing finance agency.

**§ 1268.5 Credit risk-sharing requirement.**

(a) General credit risk-sharing requirement. For each AMA product, the Bank shall implement and have in place at all times, a credit risk-sharing structure that:

(1) Requires a participating financial institution to provide the credit enhancement necessary to enhance an eligible asset or pool to the credit quality specified by the terms and conditions of the AMA product, provided, however, that such credit enhancement results in the eligible asset or pool being at least investment quality, as defined in §

1268.1; and

(2) Meets the requirements of this section.

(b) Determination of necessary credit enhancement. (1) At the earlier of 270 days from the date of the Bank's acquisition of the first loan in a pool, or the date at which the pool reaches \$100 million in assets, the Bank shall determine the total credit enhancement necessary to enhance the asset or pool to at least investment quality and to be consistent with the terms and conditions of a specific AMA product. The enhancement shall be for the life of the asset or pool. The Bank shall make this determination for each AMA product using a model and methodology that the Bank deems appropriate, provided, however, that the Bank's use of the model and methodology complies with to the requirements and conditions of paragraph (e) of this section.

(2) A Bank shall document its basis for concluding that the contractual credit enhancement required from each participating financial institution with regard to a particular asset or pool will equal or exceed the credit enhancement level specified in the terms and conditions of the AMA product and determined in accordance with paragraph (b)(1) of this section.

(c) Credit risk-sharing structure. Under any credit risk-sharing structure, the credit enhancement provided by the participating financial institution shall meet the following requirements:

(1) The participating financial institution that is providing the credit enhancement required under this this paragraph (c) shall in all cases:

(i) Bear the direct economic consequences of actual credit losses on the asset or

pool:

(A) From the first dollar of loss up to the amount of expected losses; or

(B) Immediately following expected losses, but in an amount equal to or exceeding the amount of expected losses; and

(ii) Fully secure its credit enhancement obligation subject to § 1266.7 of this chapter; and

(2) The participating financial institution also may provide all or a portion of the credit enhancement, with the approval of the Bank, by:

(i) Contracting with an insurance affiliate of that participating financial institution to provide an enhancement, but only where such insurance is positioned in the credit risk-sharing structure so as to cover only losses remaining after the participating financial institution has borne losses as required under paragraph (c)(1)(i) of this section;

(ii) Contracting with another participating financial institution in the Bank's district to provide a credit enhancement consistent with this section, in return for compensation; or

(iii) Contracting with a participating financial institution in another Bank's district, pursuant to an arrangement between the two Banks, to provide a credit enhancement consistent with this section, in return for compensation.

(d) U.S. government insured or guaranteed loans. Instead of the structure set forth in paragraph (c) of this section, a participating financial institution also may provide the required credit enhancement by purchasing loan-level insurance that is issued by an agency or department of the U.S. government or is a guarantee from an agency or department of the U.S. government, provided that the government insurance or guarantee

remains in place for as long as the Bank owns the loan.

(e) Appropriate methodology for calculating credit enhancement. A Bank shall use a model and methodology for estimating the amount of credit enhancement for a pool of AMA subject to the following requirements and conditions:

(1) The Bank shall validate its model and methodology for calculating the credit enhancement for AMA pools at least annually, or more often if necessary, and make the results of such validation available to FHFA upon request;

(2) The Bank shall institute and maintain a process to monitor the performance of its model to include tracking, back-testing, bench-marking, and stress testing the model and the results it produces, and the Bank shall make information gathered from monitoring the model available to FHFA upon request;

(3) The Bank shall inform FHFA prior to making any material changes to an approved model and methodology, providing a description of the changes that the Bank intends to make and its reasons for doing so; and

(4) The Bank promptly shall make any FHFA-directed changes to its model and methodology.

#### **§ 1268.6 Servicing.**

(a) Servicing of AMA loans may be transferred to and performed by any institution, including an institution that is not a member of the Bank System, provided that the loans, after such transfer, continue to meet all requirements to qualify as AMA under §§ 1268.3, 1268.4 and 1268.5.

(b) The transfer of mortgage servicing rights and responsibilities must be approved by the Bank or Banks that own the loan or a participation interest in the loan.



(c) A Bank shall have in place policies and procedures to ensure that the transfer of mortgage servicing rights does not negatively affect the credit enhancement on the loans in question or substantially increase the Bank's exposure to risk.

**§ 1268.7 Reporting requirements for acquired member assets.**

Each Bank shall report information related to AMA in accordance with the instructions provided in the Data Reporting Manual issued by FHFA, as amended from time to time.

**§ 1268.8 Administrative transactions and agreements between Banks.**

(a) Delegation of administrative duties. A Bank may delegate the administration of an AMA program to another Bank whose administrative office has been examined and approved by FHFA, or previously examined and approved by the Federal Housing Finance Board, to process AMA transactions. The existence of such a delegation, or the possibility that such a delegation may be made, must be disclosed to any potential participating financial institution as part of any AMA-related agreements signed with that participating financial institution.

(b) Termination of Agreements. Any agreement made between two or more Banks in connection with any AMA program may be terminated by any party after a reasonable notice period.

(c) Delegation of Pricing Authority. A Bank that has delegated its AMA pricing function to another Bank shall retain a right to refuse to acquire AMA at prices it does not consider appropriate.

Dated: December 10, 2015.

**Melvin L. Watt,**  
*Director, Federal Housing Finance Agency.*

**BILLING CODE 8070-01-P**

[FR Doc. 2015-31660 Filed: 12/16/2015 8:45 am; Publication Date: 12/17/2015]